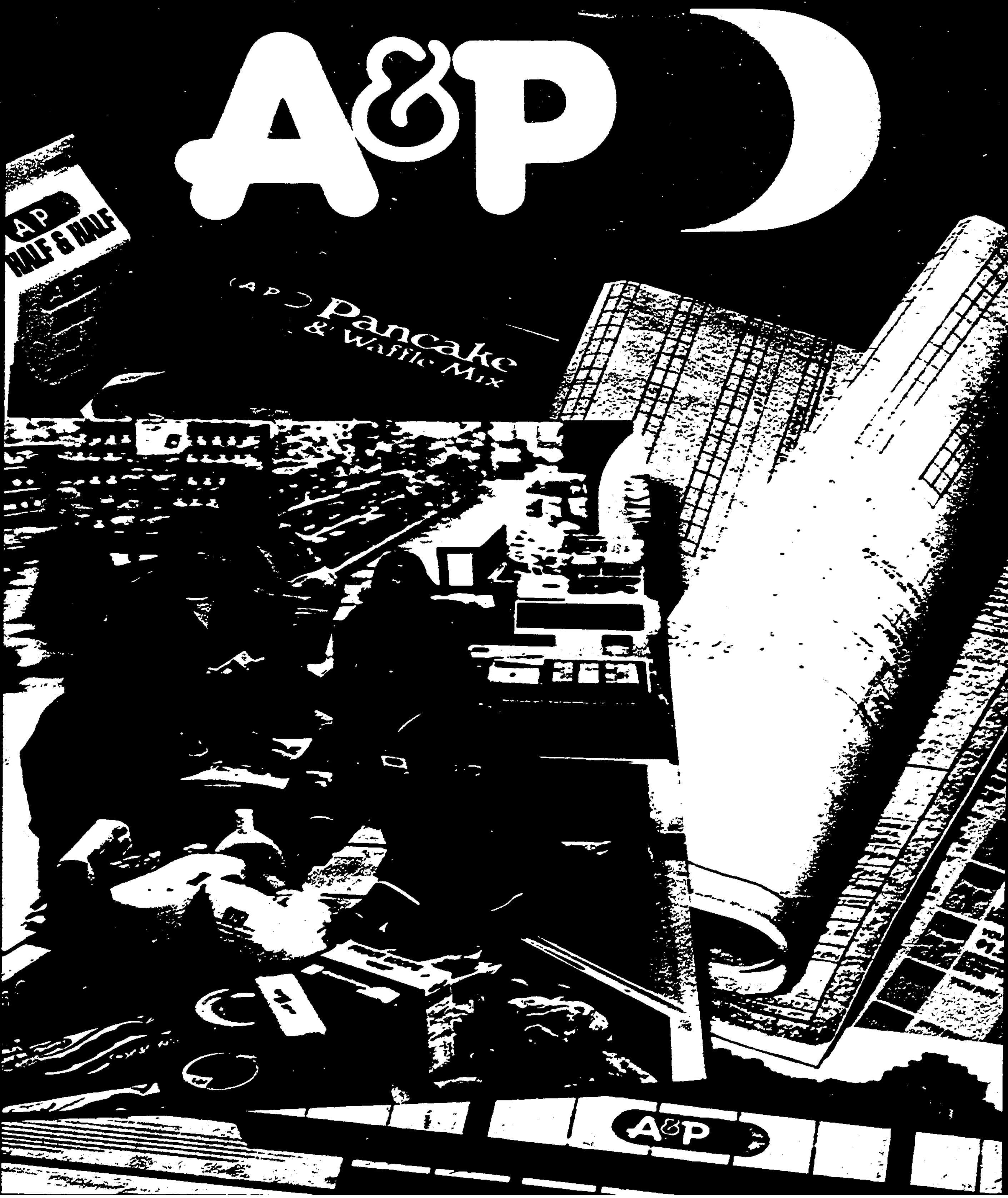
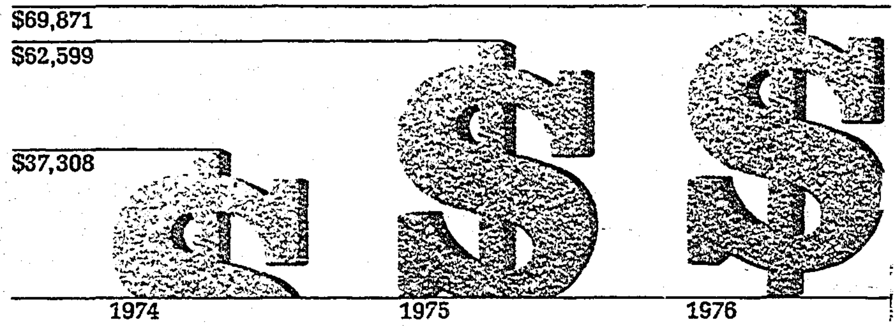
The Great Atlantic & Pacific Tea Company, Inc. Annual Report 1976



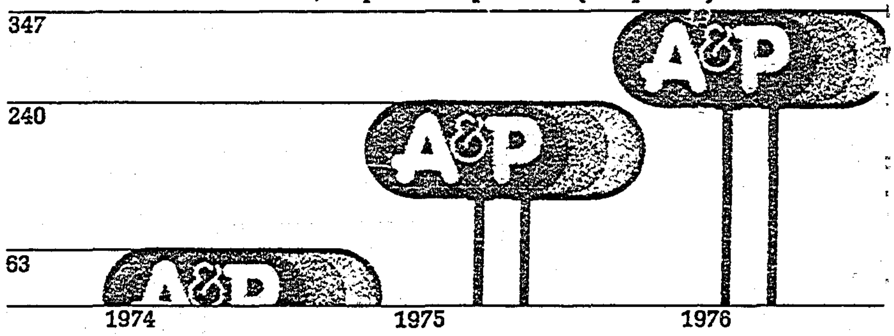
Covers

Montage of current A&P activities includes a busy checkout scene in one of our New Jersey stores, informational consumer leaflets, unit price tags, advertising aimed at minority shoppers, building plans for a *suburban supermarket*, and colorful new labels on A&P manufactured products.

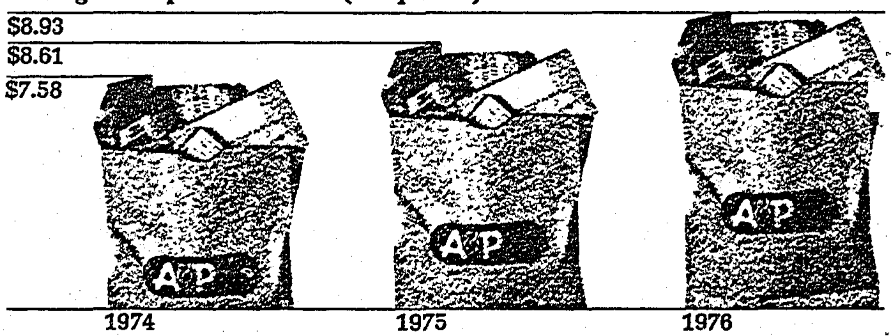
Average Weekly Sales per Store (4th quarter)



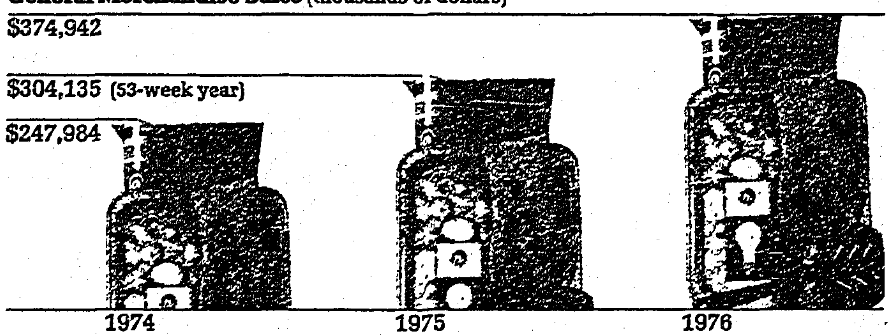
Number of Stores Over $100,000 per Week per Store (4th quarter)



Average Sales per Transaction (4th quarter)



General Merchandise Sales (thousands of dollars)



Annual Report for the Fiscal Year Ended February 26, 1977

Contents

Comparative Highlights

(Dollars in thousands except per share figures)

For the fiscal year	1976	1975
Sales*	$7,235,854	$6,537,897
Net income	23,781	4,314
per share	.96	.17
per cent of sales	.33	.07
Additions to property	94,633	65,880
Number of stores	1,978	2,074

1976 contains 52 weeks; 1975 contains 53 weeks.

*Excluding sales of stores scheduled to close.

Message to Stockholders

To Our Stockholders:

A&P achieved record sales and recorded its fifth consecutive quarter of operating profits in the fiscal year ended February 26, 1977.

The twelve-month period saw crucial adjustment of our field operations in the wake of the previous year's facilities closing programs which had left us with 40 per cent fewer retail outlets.

We responded to this challenge by selectively opening new stores, acquiring others, pulling out of some markets, and strengthening our operating position in others. Operating with fewer but larger stores, at year-end we had increased our per-store weekly sales average to $69,871, as compared with $37,308 at the start of our redevelopment program in early 1975 and $62,599 a year ago.

Total sales for the fiscal year reached $7,235,854,000, compared with $6,537,897,000 in the 53-week period the year before, an increase of 10.7 per cent. Average weekly sales for stores opened during the year was $109,600. The average sales per customer for all stores increased from $8.61 to $8.93.

While this upward sales trend was encouraging, inflated cost factors associated with the retail food business helped increase expenses and hold down earnings. Net income for the year was $23,781,000, or 96 cents per share, compared with $4,314,000 or 17 cents per share in fiscal 1975. The 1975 results included the effect of a $35 million reversal of the facilities closing reserve.

We continue to move forward with our five-year redevelopment program as a means of establishing a firm foundation for growth and achieving sustained profitability. During the year, we closed 196 loss or marginally profitable stores and opened 100 new or acquired supermarkets. We thus eliminated 3,255,000 square feet of unprofitable space while adding 2,443,000 square feet of productive area.

We also enlarged 22 stores, did major remodeling on 33 units, and minor remodeling on 71 others. Capital expenditures for retail units and support facilities came to $94.6 million.

We are now operating 1,978 supermarkets in 30 states, the District of Columbia and Canada with total square footage of 38,478,000. The size of our average supermarket has increased from 16,079 square feet at the start of our redevelopment program to 19,453 square feet today.

Our property development plans for the current fiscal year include 6[illegible] new supermarkets, 32 store enlargements, and 50 major remodels plus other support facilities at an estimated capital expenditure of $112 million.

Our wholly-owned subsidiary, Family Center, Incorporated, opened its first 55,000 square-foot combination food and drug supermarket during February in Greenville, South Carolina. Operating independently out of its headquarters in Atlanta, Georgia, Family Center plans to open seven similar units this year.

We are committed to a program of replacing poorer facilities, and creating new growth. Our capital assets program will remain high for the foreseeable future.

We are also engaged in a concerted program to conserve energy in our stores, plants and warehouses.

Compass Foods, Incorporated, our subsidiary handling sales of A&P products to other food merchandisers in the United States and abroad, is expanding its sales activities.

In a move to profitably consolidate the operations of the farflung manufacturing plants which supply Compass Foods and A&P stores with quality private label products, we have reorganized our Dairy, Coffee and Ann Page plants into a single Manufacturing Group.

Under this compact new arrangement, the Coffee and Dairy divisions function out of our former Coffee Division headquarters in Landover, Maryland and the Grocery Division, comprising all the former Ann Page Division plants, is headquartered at the former Ann Page Division plants headquarters in Horseheads, New York. Industrial and general engineering functions are now centered in our Montvale, New Jersey headquarters.

At the retail level, acquisition of 62 profitable supermarkets from National Tea Company in November substantially improved the merchandising performance of our Chicago and Milwaukee operating divisions. Sale of 2[illegible] A&P supermarkets in the St. Louis area led us to consolidate the 13 remaining stores in that division into our Chicago operation and one into the Louisville Division.

Because store closings in certain other areas left us with management structures beyond our present needs, we found it expedient to consolidate

some divisional functions. The administrative and buying activities of our Boston, Springfield, and newly-combined Albany-Scranton divisions have been centralized in our Northeastern Region headquarters offices. Our Charlotte and Raleigh divisions were merged into a single Carolina Division, the Birmingham Division became part of the Atlanta Division, and the Columbus Division was consolidated with the Indianapolis Division.

We also strengthened our regional operating structure by dividing supervision of the eight regions between two executive vice presidents: William I. Walsh and John J. Miles. Mr. Walsh is responsible for the Northern group of regions, consisting of Mid-Western, Central, Canada and Northeastern. Mr. Miles is supervising the Coastal group, consisting of Metro, Keystone, Atlantic and Southern.

Our company-wide employee retraining program continued to get top priority attention, particularly at the store level, to assure that A&P people are keyed into the company's operating objectives and that A&P customers get helpful, courteous service at all times.

Affirmative Action units established in each region concentrated on bringing greater numbers of minority group persons and women into the A&P work force. Our stores continued to stock products from minority group manufacturers and suppliers, and new A&P advertising and marketing campaigns were directed toward residents of minority group communities.

Following through on our corporate commitment to expand service to inner city neighborhoods, we built several new stores and renovated others in these areas. One such supermarket recently opened in Chicago measures 41,152 square feet—the largest food store in our chain.

The broadscale revamping of our in-store merchandising procedures begun a year ago is continuing and when completed will pay off in greater customer satisfaction and increased sales. In the fourth quarter, we had 347 stores with sales volume of $100,000 or more a week. This compares with 240 such stores a year earlier and 63 the year before.

Our stores are cleaner, brighter and better appointed. Many of them have added new departments—bakeries, floral and greeting card units, wine and liquor sections. A much broader line of general merchandise and a larger selection of national brand products are available. Most stores are open longer, many on a 24-hour basis.

Electronic cash registers capable of being tied into electronic scanners were installed in 81 existing stores and all new, enlarged and remodelled stores, giving us a total of 283 stores with this advanced checkout system. Testing of product scanning in two of our New Jersey stores is proving quite successful.

Refining of our management structure in response to operational imperatives resulted in a number of new executive appointments. The most recent came in February, when David W. Morrow joined the company as vice chairman and chief operating officer. Formerly president of Albertson's, Inc., Mr. Morrow brings 28 years of operating experience to A&P.

Our thanks and gratitude are extended to three members of our Board —William Corbus, Robert F. Longacre and John M. Schiff—who are stepping down after many years of faithful and constructive service.

Messrs. Corbus and Longacre began their careers with A&P, serving 43 and 29 years respectively. Mr. Corbus, a director since 1964, was most recently our vice chairman, government relations. Mr. Longacre, a director since 1971, was vice chairman and chief operating officer.

Mr. Schiff, since his election to the Board in 1963, has helped guide the company through one of the most crucial periods in its history. The company and I especially want to express our appreciation to him for his many contributions.

We extend a greeting to the new Board members—Mr. Morrow, Walter D. Dance, vice chairman of the Board of the General Electric Co., and Allan A. Feder, President of our Manufacturing Group.

Finally, a note of appreciation to the 90,000 employees and the many suppliers of A&P who unstintingly direct their energies toward keeping our vast redevelopment program on track. With their continued support and the encouragement of shareowners, we expect to exert a strict discipline on expenses and increase sales in the current fiscal year.

J. L. Scott

Jonathan L. Scott
Chairman and
Chief Executive Officer
May 12, 1977

Grant C. Gentry, President and Chief Administrative Officer
Jonathan L. Scott, Chairman and Chief Executive Officer
David W. Morrow, Vice Chairman and Chief Operating Officer

Noonday shoppers at our new store in Lindenwold, New Jersey, one of many large supermarkets A&P is building with improved customer service, comfort and convenience in mind.

Our Goal: Please the Customer

A&P is now approaching the mid-point of a five-year redevelopment program designed to restore the company to a posture of sustained profitability. This undertaking is immense and costly, yet its success is dependent on fulfilling a very basic operating precept on which the company began building 118 years ago: *Please the customer.*

Pleasing the A&P customer of a century and more ago

meant conducting a reliable mail order business in inexpensively-priced tea, coffee and spices, and in making these products available in the hinterland via Wells Fargo wagons.

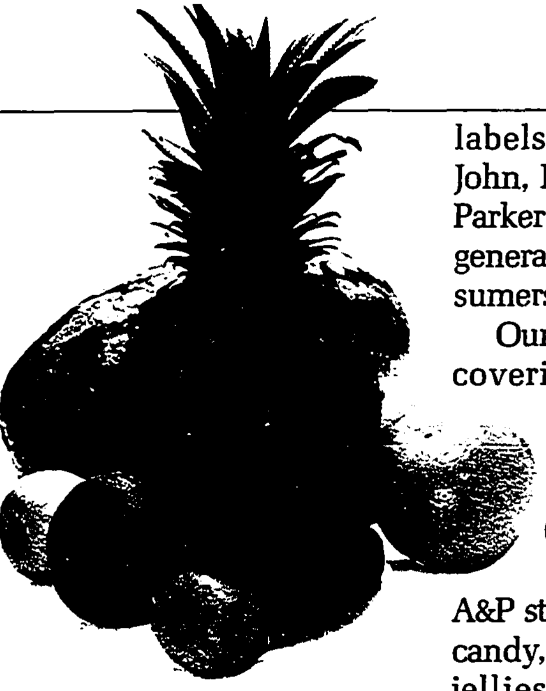
A&P customers of a half century ago in some 15,000 spic and span "neighborhood" stores across the nation saw the emphasis placed on courteous, intelligent service, high quality merchandise and fair prices.

Today, A&P continues to measure its customer performance against these time-honored standards of service in our 1,978 large "one-stop" supermarkets. And, as they have for many years, our customers also may select from a broad line of privately-manufactured baked goods, canned fruits and vegetables, frozen foods, jams, jellies, coffee, and many other products over which the company maintains strict quality control and which it sells at prices below comparable national brands.

The task of making certain that customers walk out of A&P stores not only pleased, but desirous of returning is shared by more than 90,000 employees in the company's stores and farflung offices, laboratories, warehouses and manufacturing plants. Each of them is helping A&P make its stores more sensitive to changing attitudes and trends in consumerism.

Getting the Best Merchandise into our Stores

Among the first links in our vast store-support chain are the skilled A&P buyers in our national meat and produce divisions who maintain daily communication with major packers, suppliers and growers to assure customers of the best quality meats, fruits and



vegetables. Still other experienced members of our procurement and supply team select the best available food and general merchandise products for our stores at competitive prices.

As a convenience to customers, we are offering a greater assortment of health and beauty aids, housewares, footwear, soft goods, games, toys, greeting cards, novelties, gifts, live plants and cut flowers, automotive supplies, and other items.

A&P stores also carry a wide choice of gourmet and health foods, as well as increasing quantities of frozen convenience foods to reduce meal preparation time for working housewives and other people on the move.

While most of the 12,000 or more products on our shelves are national brands, A&P canneries, bakeries, coffee roasting plants and other processing and manufacturing installations around the country bring our customers many quality products bearing such

labels as Ann Page, Cap'n John, Eight O'Clock and Jane Parker—household names to generations of American consumers.

Our manufacturing facility covering 35 acres in Horseheads, New York is the world's largest food plant. As one of eight Grocery Division plants supplying foodstuffs to A&P stores, its output includes candy, peanut butter, jams and jellies, tea, spices, extracts, mayonnaise, mustard, relishes, vinegar, salad dressings,

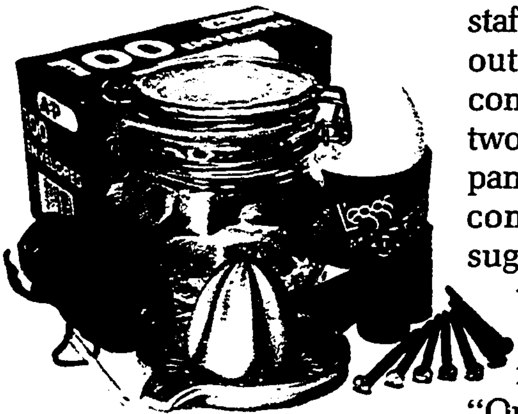
soups, fruit drinks, gelatin and pudding mixes. Familiarly known to employees and area residents as "the big Ann Page kitchen," Horseheads has become a popular tourist attraction. Some 22,000 saw Ann's kitchen helpers in action last summer.

Also supplying A&P-manufactured and processed products to our customers are eight bakeries, four coffee plants, and six dairy plants. Still other A&P private-label products are produced to our specifica-

tions by contract with outside manufacturers.

Assuring Our Customers Top Quality

Keeping a watchful eye on products produced in our manufacturing plants to assure A&P shoppers of uniformly high quality food and



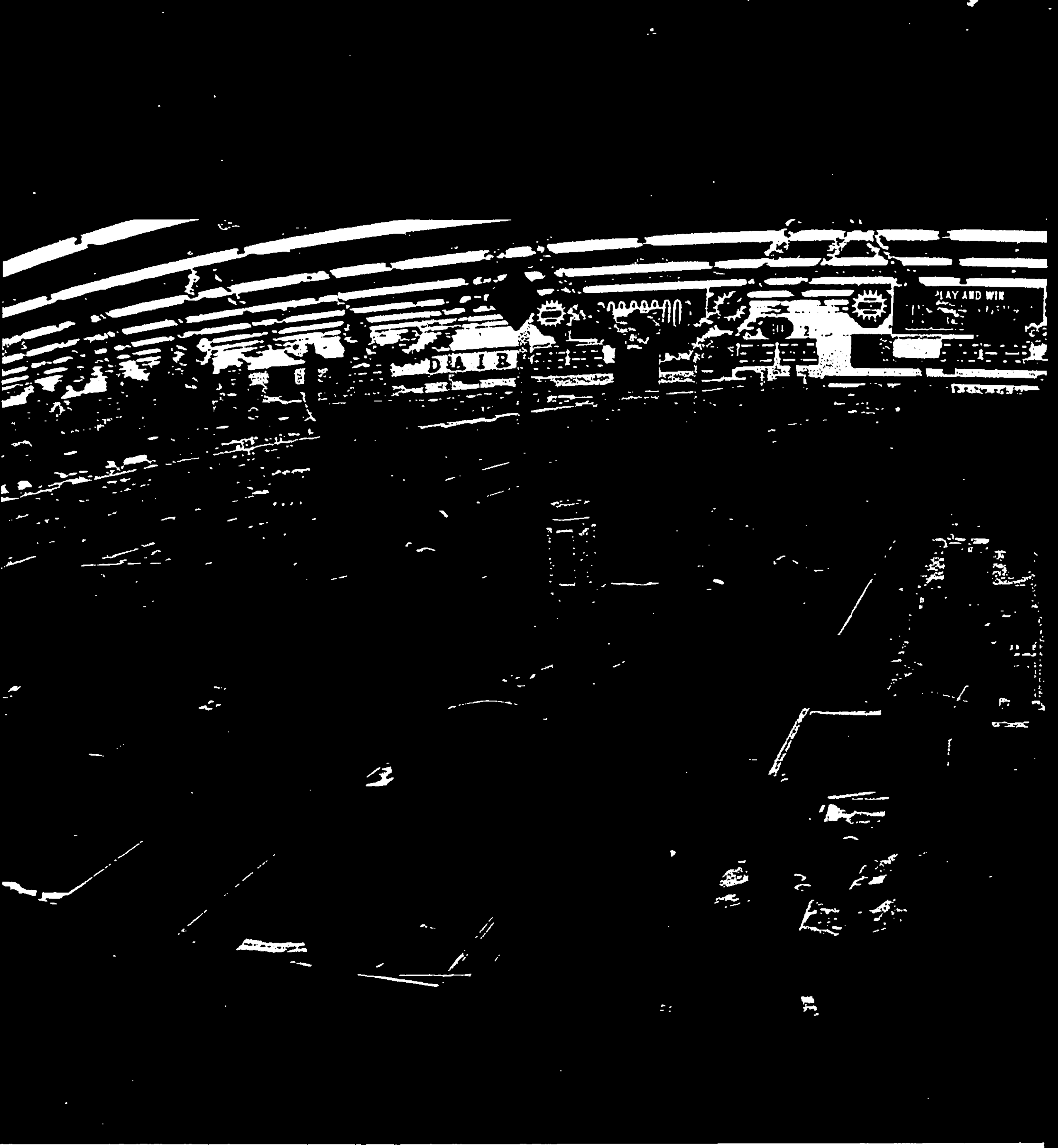
merchandise is an impressive contingent of research technologists located in our modern testing laboratory at headquarters and in our network of plant laboratories.

Heading the quality assurance sleuths at headquarters is Dr. Eugene Bilenker, a graduate of the Massachusetts Institute of Technology who over the course of 21 years has acquired a position of respect in his profession. His stiff battery of laboratory tests touch on all aspects of individual products, including bacteria count, acidity, texture, spiciness, sweetness, freshness, and wholesomeness. They also grade packaging materials, drained weight levels, label information, and the like. Panels of outside consumers are also enlisted to lend impartial assistance in product testing.

Tuning in to Consumers

Yet another stalwart in the "watchful eye" brigade serving A&P stores is Katherine Smith, our vice president for Consumer Affairs. She and her staff are constantly on the lookout for ways to better meet consumer needs. Her job is two-fold: to be sure the company listens and responds to consumer complaints and suggestions, and to provide valuable food shopping information to A&P customers. A&P stores maintain "Operation Aware" centers which offer instructional leaflets on such consumer topics as nutrition labeling, open dating, unit pricing, and tips on how to shop most economically.

We put our reputation on the line in all our stores.



A typical new A&P supermarket in Fairview, New Jersey, offers customers wide, well-lighted aisles, an expanded line of food and general merchandise products, and electronic registers to provide speedy, accurate and more informative checkout service.

Lest any consumer be in doubt as to the seriousness of the A&P commitment to economy, quality and service in food shopping, the following tenets of our consumer philosophy are prominently displayed in all A&P stores.

The Right to 100% Satisfaction
Product replacement or purchase price refund.

The Right to Safe and Healthful Products
Our own quality control

systems in addition to Federal and State inspection.

The Right to Quality
At the lowest possible price, which means greatest value in every purchase.

The Right to Freshness
All A&P perishable and semi-perishable products are open-dated and show the date such products may no longer be offered for sale at full price.

The Right to be Informed
Through such programs as A&P's Operation Aware Centers for consumer news, recipes and other consumer information.

The Right to Sale-Item Availability
Should product unavailability exist, a comparable item or rain check will be offered.

The Right to Courtesy
For each and every customer from each and every A&P employee.

The Right to Choose
From a wide variety of famous brands including A&P family brands.

The Right of Direct Communication
To our managers in the red blazers; to our headquarters through our Operation Aware Centers.

The Right to Convenient and Clean Stores
To provide a pleasant shopping environment for you.

Consumer reaction to the use of electronic scanners at A&P checkout counters is being sought at two A&P stores in New Jersey. The electronic scanners read Universal Prod-

uct Code markings on individual items and feed the information into computers, thus providing fast, accurate checking of merchandise and more informative sales receipts. Scanners also help store managers keep up-to-the-minute information on shelf stock and aid them in selecting and ordering merchandise.

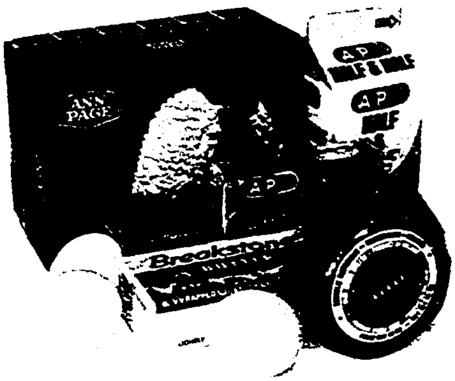
A major advantage to customers in our use of scanners is accuracy. Scanners also relieve clerks of the job of figuring multiple-priced items, sales tax, deductions for coupons, and food stamps. Because the computer handles each of these tasks, the checkout clerk is in a position to give more attention to the customer.

New Stores Improve Service, Conserve Energy

Greater customer convenience and operating efficiency are hallmarks of the new, larger A&P supermarkets being built throughout our chain. The stores feature delicatessens, floral and greeting card departments, and other selective product groupings. Checkout areas are open, uncluttered, and equipped with electronic cash registers.

Energy conservation in our stores is the result of a concerted company-wide campaign to do our part in helping our nation face up to the energy crisis. Heading this long-range project, which we expect will substantially reduce our fuel and electric consumption, is James F. Kernan, our national manager of engineering equipment and utilities and chairman of the Energy Conservation Committee of the Food Marketing Institute.

We are already reducing our use of energy in heating 342 of our stores by systematically recirculating warm air emitted from air-conditioning and refrigeration units. Energy



savings have been effected at the receiving docks of our new stores through installation of door seals against which trucks are backed for loading. Use of multideck glass-door frozen food cases have helped reduce our use of electricity.

In the realization that the energy shortage is something all of us have to learn to live with, we have an energy task force surveying all A&P stores, plants and warehouses to determine optimal energy requirements and to search out all areas for conservation of fuel and electricity.

Our People Make the Difference

On the theory that service in a supermarket is only as good as the dedication of the people who work there, A&P leaves little to chance in staffing its stores with well-trained personnel.

Utilizing the most up-to-date videotape training equipment in combination with practical in-store instruction, we seek to impress on every employee from the receiving dock to the checkout counter the urgency of serving consumers with sensitivity and dispatch.

Since the start of our redevelopment program, some 50,000 employees, including 27,000 checkout clerks, have benefited from training programs aimed at helping them do a better job. Emphasis is placed on the importance of friendly, helpful service, a neat appearance, and a pleasant, positive attitude toward customers. Training courses also keep employees up to date on technological developments in our stores.

Professional development at the management level is implemented through a joint program with the American

Management Association. In a series of seminars, management people are advised on ways to effectively work with and motivate employees and on techniques for improving their own decision-making skills.

Conducting a management development seminar for Manufacturing Group executives is Robert V. Delevante, our manager, Manpower Planning and Development.

We are conducting special training programs to assist women and minorities gain management advancement. At year-end, we had 30 women serving as store managers and 46 as assistant managers. Another 11 women are training to be managers and 54 to be assistant managers. Our stores have 63 minorities managers and 153 assistant managers. Another 26 are in training for managers posts and 69 for assistant managers.

In an effort to do construc-

tive work in the minority communities we serve, we last year had deposits in minority-owned financial institutions and were doing business with several minority-owned companies. We also purchased products and services from a large number of minority-owned firms.

Building for the Future

One of the most important undertakings in our long-range plans for meeting consumer needs in our stores is property development. The many professionals in this area of A&P activity are responsible for our continuing program of opening larger stores in more convenient locations and for modernizing and expanding others. Their objective is to raise our entire store network to the highest possible standards of convenience, attractiveness and operating efficiency.

These experts also create new departments where we offer a broader selection of the merchandise today's more sophisticated and more active consumer demands. They are the ones who have created many of our heavily patronized departments—health and beauty aids, frozen foods, floral, bakery—veritable stores within stores.

Together with the thousands of other A&P people working throughout our 118-year-old company, their number one goal is to strengthen our capability for pleasing the customer.

Following is a summary of the Company's accounting policies that significantly affect the determination of financial position and results of operations.

Fiscal Year—The Company's fiscal year ends on the last Saturday in February. Fiscal 1976 ended February 26, 1977 and comprised 52 weeks, whereas fiscal 1975 ended February 28, 1976 and comprised 53 weeks.

Principles of consolidation—The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant inter-company accounts and transactions have been eliminated.

Facilities closing program—Operating results of stores included in the facilities closing program are excluded from the statement of consolidated income (from the effective date of inclusion in the facilities closing program) and charged to reserves provided therefor, together with closing costs, ongoing lease payments and net losses on disposal of related property. As to stores closed outside of the facilities closing program, the present value of the estimated remaining lease obligations are accrued at the time the date for closing the store is established.

Foreign operations—Assets and liabilities of foreign subsidiaries have been translated at year end rates except for inventories, net property and certain deferred items which have been translated at historical rates. Income and expense accounts, except cost of sales and depreciation and amortization, have been translated at average rates prevailing during the fiscal year. Foreign exchange losses in fiscal 1976 amounted to $1.1 million compared with a gain of $1.2 million in fiscal 1975. The fiscal 1975 exchange gain included $1.1 million resulting from a change in the method of translating foreign currency amounts to comply with Statement No. 8 of the Financial Accounting Standards Board.

Inventories—Inventories are stated at the lower of cost or market, with cost being determined on the following bases: inventories in stores—average cost under the retail method; majority of remaining inventories—cost on a first-in, first-out basis. Raw materials and supplies, principally at manufacturing facilities, constitute approximately 10% of total inventories in fiscal 1976 and 6% in fiscal 1975.

Properties—The Company leases a substantial portion of its facilities all of which presently are accounted for as operating leases for financial reporting purposes. Most of the leases presently negotiated by the Company and many existing leases are considered capital leases under FASB Statement No. 13 which requires the capitalization of such leases entered into after January 1, 1977 and eventual retroactive capitalization (presently by 1981) of all pre-1977 capital leases.

Owned properties, consisting almost exclusively of manufacturing facilities and warehouses and equipment, are stated at cost. Store fixtures and leasehold improvements are stated at amortized cost. Major renewals and betterments are capitalized, whereas maintenance and repairs are charged to operations as incurred. Commencing with fiscal 1976, gains or losses on normal disposition of assets are recognized currently whereas in prior years recognition was deferred until all assets in a depreciation group were fully depreciated. The effect of this change was not material. Fully depreciated property is written off against the related depreciation reserve. Net losses on disposition of properties included in the facilities closing program have been charged to the reserve provided therefor.

Depreciation and amortization—For financial reporting purposes, depreciation and amortization are provided, generally on the straight line method, over the estimated useful lives of the respective assets. Approximate annual depreciation rates for properties are as follows: store and other equipment, except automotive—8⅓% to 10%; buildings—2% to 5%; store fixtures and leasehold improvements—10% to 12½%; and automotive equipment—14-2/7% to 33⅓%.

Pre-opening costs—Expenses incurred in the opening of a new store are charged to expense in the quarter in which the store is opened.

Income taxes—Deferred taxes have been provided in prior years in recognition of timing differences between income for financial reporting and income tax purposes. Approximately $7 million of deferred income taxes have not been provided on undistributed earnings of foreign subsidiaries considered to be permanently invested. Investment tax credits are deferred and amortized over the estimated useful lives of related assets.

Retirement Plans—Annual costs of the Companies' retirement plans are funded currently. Commencing with fiscal 1976, the method of computing annual costs of the Companies' U.S. pension plans was modified so as to consist of normal cost plus amortization of unfunded prior service costs as of January 1, 1976 over 40 years and amortization of annual actuarial gains or losses over 15 years. Prior to fiscal 1976, annual costs consisted of normal cost plus interest on prior service costs with amortization of actuarial gains or losses over 6 to 20 years. This modification and other changes in the plan effective January 1, 1976 did not materially affect pension costs in fiscal 1976.

Earnings per share—Net income per share is based on the weighted average number of common shares outstanding during the respective fiscal years. Stock options outstanding (common stock equivalents) had no dilutive effect and, therefore, were excluded from the computation of earnings per share.

Fiscal 1976 Sales and Net Income
(Unaudited as to interim amounts)

Sales for fiscal 1976 were $7.2 billion or 11% above fiscal 1975 sales of $6.5 billion. Fiscal 1976 comprised only 52 weeks, whereas fiscal 1975 comprised 53 weeks. See discussion below under "Facilities Closing Program" for information on the operations of store and support facilities included in the facilities closing program and excluded from the statement of income. Results for the third and fourth quarters of fiscal 1976 include the operations, from November 14, 1976, of 62 stores acquired from National Tea Company, which results were not significant for the year, but did contribute substantially to the sales increase in the fourth quarter of fiscal 1976.

The Company experienced dramatic improvement in the sales of continuing stores beginning with the second quarter of fiscal 1975 as it consolidated facilities and inaugurated advertising, personnel training, merchandising and store renovation programs. Sales also were favorably affected by the retention of many customers from closed stores. Total sales by quarter and the percentage increase in average weekly sales over those of the corresponding quarter in the preceding fiscal year, are shown below:

Quarterly and Average Weekly Sales

(Millions)	Fiscal 1976			Fiscal 1975		
		Average Weekly Sales			Average Weekly Sales	
Quarter	Sales By Quarter	Dollars	Percent Change	Sales By Quarter	Dollars	Percent Change
First	**$1,734**	**$133**	23%	$1,407	108	(20%)
Second	**1,789**	**138**	14%	1,570	121	(8%)
Third	**1,810**	**139**	6%	1,699	131	(1%)
Fourth	**1,903**	**146**	10%	1,862	133	2%
	$7,236			$6,538		

The Company does not believe that sales increases of the magnitude experienced earlier in fiscal 1976 will continue as indicated by the declining rate of sales increase noted above. Earnings performance in fiscal 1977 will, to a large extent, depend on the Company's ability to increase sales per store beyond the current rate while bringing about expense disciplines. As a result of the declining trend in earnings during the last half of fiscal 1976, the Company took several steps in the fourth quarter, including the closing of eight division offices and the addition of approximately 85 stores and several support facilities to the facilities closing program.

Net income of $23.8 million for fiscal 1976 is after an extraordinary credit of $10 million representing utilization of the Company's tax loss carry forward in an amount equivalent to a normal U.S. tax provision that would have otherwise been applicable to those earnings. Fiscal 1976 earnings include a charge of $500,000 representing a net addition to the facilities closing reserve in the fourth quarter, a pre-tax charge of approximately $5.2 million in the first quarter for the value of equipment disposed of at two warehouses and retail store signs being replaced, and a $1.3 million credit in the third quarter from the settlement of a service contract.

Net income of $4.3 million for fiscal 1975 is comprised of a pre-tax loss of $32.1 million from ongoing operations, a credit of $35 million ($15 million in the second quarter and $20 million in the third quarter) representing net reductions in the Company's facilities closing reserve, a charge of $7 million in the second quarter attributable to the settlement of an antitrust suit, a credit provision for income taxes of $6.6 million, and a $1.8 million extraordinary credit in the fourth quarter, representing the utilization of a carry forward tax loss by a Canadian subsidiary.

Quarterly Operating Results

	Net Income (Loss) (Thousands)		Per Share Amounts	
Quarter	**1976**	1975	**1976**	1975
First	**$ 6,303**	$(4,682)	**$.25**	$(.19)
Second	**10,682**	3,848	**.43**	.16
Third	**5,085**	2,417	**.21**	.09
Fourth	**1,711**	2,731	**.07**	.11
	$23,781	$4,314	**$.96**	$.17

Facilities Closing Program

As of the end of fiscal 1976 the facilities closing program reserve was increased by $9.5 million to cover the cost of closing approximately 85 additional stores and several support facilities. This additional reserve was largely offset by a reversal of $9.0 million relating to the existing facilities closing reserve. The net addition to the reserve of $500,000 was charged to expense in the fourth quarter of fiscal 1976.

The original facilities closing program reserve of $200 million was established at the end of fiscal 1974 representing the estimated cost of a facilities closing program that contemplated the closing of approximately 1,250 unprofitable and marginal stores and certain related support facilities. Modifications to that program during fiscal 1975 ultimately increased the number of stores to be closed to approximately 1,360 and added additional support facilities. Net reductions of $35 million were made in the facilities closing reserve in fiscal 1975 even though the number of stores and support facilities to be closed was increased by 77 stores plus additional support facilities in the second quarter of 1975, decreased by 13 stores in the third quarter of 1975, and increased by 45 stores in the fourth quarter of 1975. The increase in the reserve resulting from the inclusion of these additional units in the closing program was $36 million.

Sales of stores closed or to be closed under the facilities closing program amounted to $51 million in fiscal 1976 and $401 million in fiscal 1975. Sales and operating results of these stores and support facilities have been excluded from the statement of income for fiscal 1976 and 1975 from the effective dates of inclusion in the program. The operating results of the stores and support facilities added to the closing program at the end of the fourth quarter of 1976 have been included in the statement of income for the entire fiscal year.

Costs of $129.6 million, including $44.1 million in fiscal 1976 and $85.5 million in fiscal 1975, have been charged to the closing reserve. These costs include operating losses prior to closing, net loss on disposal of properties, employee severance payments and other benefits, costs of dismantling, moving and restoring properties, and lease payments after the facilities were closed.

While management believes that the reserve is adequate to cover the remaining closing program costs, future adjustments of the reserve are possible.

An analysis of the components of the facilities closing reserve and the charges to and adjustments thereof is shown below:

Facilities Closing Program Reserve

(Millions)	Current Liabilities	Property Valuation	Non-Current Reserve	Total
Balance February 22, 1975	$100.0	$46.0	$54.0	$200.0
Charges	(70.5)	(15.0)		(85.5)
Adjustments:				
Reduction in reserve	(21.0)	(27.0)	(23.0)	(71.0)
Increase for inclusion of additional units in program	13.0	11.0	12.0	36.0
Transfer to current liabilities	6.0		(6.0)	
Balance February 28, 1976	27.5	15.0	37.0	79.5
Charges	(37.9)	(6.2)		(44.1)
Adjustments:				
Reduction in reserve		(7.4)	(1.6)	(9.0)
Increase for inclusion of additional units in program	7.7	1.6	.2	9.5
Transfer to current liabilities	21.2		(21.2)	
Balance February 26, 1977	$ 18.5	$ 3.0	$14.4	$ 35.9

Income Taxes

At the end of fiscal 1976 the Company had an operating loss carryforward for financial statement purposes of approximately $104 million, which arose principally from the provisions for the facilities closing program. The corresponding net operating loss carryforward for U.S. income tax purposes is approximately $115 million, which expires in fiscal 1982 and 1983. In addition, the Company has unused investment tax credits of approximately $20.3 million. These unused credits, which have not been recorded for financial statement purposes, will expire as follows: February 1982–$4.6 million, February 1983–$8.3 million and February 1984–$7.4 million.

The fiscal 1976 provision for income taxes includes a charge in lieu of U.S. federal income taxes in the amount of $10 million and an equivalent amount has been reflected as an extraordinary credit in the statement of income in recognition of the corresponding income tax benefit. The Company will, in future years, continue to reflect as an extraordinary credit that portion of its operating loss carryforward which it realizes for financial statement purposes. The $1.8 million extraordinary credit in fiscal 1975 represents the utilization by a Canadian subsidiary of its entire income tax loss carryforward.

The Company's effective income tax rates are 43% for fiscal 1976 and (162%) for fiscal 1975. The credit provision for income taxes in fiscal 1975 results principally from a $7.2 million adjustment of deferred taxes arising from a decrease in the estimated service lives of store and other equipment as of the beginning of fiscal 1975. The difference between the U.S. statutory rate of 48% and the effective rates is also attributable, in both years, to the Company's policy of amortizing investment tax credits, the effective rates of state and local income taxes, and to unrealized foreign exchange translation gains and losses which were not given recognition for income tax purposes.

The deferred tax provision for depreciation represents principally the use for tax purposes by a Canadian subsidiary of depreciation previously deducted for financial statement purposes.

Provision for Income Taxes

(Thousands)	Fiscal 1976	Fiscal 1975
Current		
U.S. and Canadian	$10,176	$(5,617)
State and local	100	(25)
Investment Credits		
Deferred		(6,800)
Amortization	(1,805)	(1,808)
Deferred U.S. and Canadian	1,974	7,650
	$10,445	$(6,600)

Deferred U.S. and Canadian Tax Provision

(Thousands)	Fiscal 1976	Fiscal 1975
Depreciation	$1,974	$ 250
Income tax refund from carryback of operating loss	—	7,800
Adjustment of deferred investment tax credit	—	6,800
Adjustment resulting from change in equipment service lives	—	(7,200)
	$1,974	$7,650

Long-Term Debt

In December 1975, the Company concluded a $150 million revolving credit agreement, expiring February 23, 1980, with a group of eleven banks and a 7½ year $50 million term loan agreement with a group of four banks. The $50 million term loan bears interest at 124% of each bank's prime rate to February 24, 1979 and at 128% of prime thereafter. Interest requirements under the $150 million revolving credit agreement consist of interest on borrowings at ¼% over each bank's prime rate to February 24, 1979 and at ½% over prime thereafter, plus a commitment fee of ½% per annum on the average daily unused portion of the commitment and a facility fee of ¼% per annum on the full amount of the commitment. Both agreements provide that advances and installments may be prepaid at any time without penalty.

With respect to the revolving credit agreement, there are informal arrangements with the banks to maintain compensating balances, expressed in bank collected balances. The Company is expected to maintain average monthly bank collected balances totaling approximately 10% of the commitment plus 10% of the loans outstanding. Such compensating balance requirements are not significant in relation to the Company's recorded cash balances.

The credit agreements, among other things, prohibit the declaration of dividends until such time as the Company realizes net income exclusive of reversals of the facilities closing reserve (as further defined in the agreements) for four consecutive quarters, which condition has been met as of the third quarter of fiscal 1976. Furthermore, aggregate dividend payments are limited to 15% of net income earned after February 28, 1976 until February 1978 and 30% thereafter. Also, the Company is required to maintain on a consolidated basis: a current ratio of not less than 1.4 to 1 commencing with fiscal 1977; an excess of current assets over current liabilities of not less than $200 million during fiscal 1977, $270 million during fiscal 1978 and $300 million during fiscal 1979 and thereafter; and, pursuant to an amendment of the agreement effective February 27, 1977, tangible net worth of not less than $465 million through August 1977, $475 million thereafter through February 25, 1978, $495 million thereafter through August 1978 and at increasing amounts thereafter up to $600 million at February 24, 1980. The required amounts of tangible net worth would be in-

creased by the amount of any reversals of provisions for the facilities closing program after fiscal 1976. At February 26, 1977 current assets exceeded current liabilities by $243 million, the current ratio was 1.6 to 1 and tangible net worth amounted to approximately $470 million.

Long-term debt at February 26, 1977 consists of the $50 million term loan, $48 million outstanding under the revolving credit agreement and mortgages and other notes payable of $9.6 million, including $4.9 million on a mortgage of an existing facility completed during fiscal 1976. The $50 million term loan is payable quarterly commencing November 1978 with eleven installments of $2 million, followed by six installments of $3 million and a final payment of $10 million in February 1983. The mortgages and other notes are payable at the rate of approximately $.5 million per year through 1981 and $7.2 million thereafter. Long-term debt at February 28, 1976 comprised the $50 million term loan, $24 million outstanding under the revolving credit agreement and $4.5 million of mortgages payable.

During fiscal 1976 and 1975, average daily bank borrowings amounted to $71 million and $51 million, respectively, and the maximum amount payable at any month end was $122 million and $80 million, respectively. Average daily interest rates under the revolving credit agreements were 6.7% during fiscal 1976 and 8.1% during fiscal 1975. The average daily interest rates for the term loan were 8.4% during fiscal 1976 and 9.0% during fiscal 1975.

Capital Expenditures

Capital expenditures, principally for equipping new supermarkets and renovating existing stores, were $95 million in fiscal 1976 and $66 million in fiscal 1975. Capital expenditures for 1976 include approximately $25 million representing the acquisition of stores from others. Depreciation and amortization charges were $54.6 million and $53.7 million in fiscal 1976 and 1975, respectively.The Company anticipates that capital expenditures will be approximately $100 million annually for the next several years. The Company presently plans to construct approximately 70 stores during fiscal 1977. The stores constructed during fiscal 1976 averaged approximately 31,000 square feet excluding the first Family Mart store operated by a wholly owned subsidiary, with a total area of 55,000 square feet.

At present, capital expenditures normally are limited to the cost of equipping and fixturing a store, as the store facilities generally are leased. During 1976, the Company began a sale-leaseback program for Company developed projects. Approximately $14.6 million of costs of these Company developed projects is included in the caption "Properties held for development and sale" in the accompanying balance sheet. As indicated in the Summary of Significant Accounting Policies, the leases relating to the sale-leaseback program and most other leases entered into after January 1, 1977, as well as many existing leases, will ultimately be capitalized under the provisions of FASB Statement No. 13.

The Company has a commitment providing for leasing of new store equipment having an aggregate value (as defined) of $16.7 million.

Stockholders' Equity

Stockholders' equity at February 26, 1977 amounted to $471.5 million or $18.94 per share of common stock outstanding as of that date. Capital surplus increased by $105,000 and $21,000 in fiscal 1976 and 1975, respectively, representing the excess of proceeds over the aggregate par value of shares issued upon the exercise of stock options.

The Company has not paid a dividend since November 1974 and is limited as to the amount of the dividends that may be paid under the terms of its loan agreements. See the discussion under Long-Term Debt concerning certain dividend restrictions. At February 26, 1977 approximately $3.6 million of retained earnings was available for the payment of dividends.

Stock Options

The Company has a stock option plan approved by the Stockholders in June 1975 for granting officers and key employees qualified or non-qualified options to purchase not more than 1,000,000 shares of common stock at not less than the fair market value at grant dates and for periods not exceeding ten years. In addition, options granted previously under a stock option plan approved by the Stockholders in 1969 were outstanding during fiscal 1975 and 1976. A summary of option transactions is shown on the right:

Non-qualified options are exercisable as follows: 274,100 immediately and as to the remaining 196,000 at cumulative 25% increments after each of the first through the fourth annual anniversaries of the grants. Qualified options are exercisable at cumulative 25% increments after each of the first through the fourth annual anniversaries of the grants. 277,500 options were available at February 26, 1977 for future grants.

Summary of Option Transactions

	Shares		Option Price	
	Qualified	Non-Qualified	Per Share	Total
Outstanding, February 22, 1975	256,300		$9.625 to $27.875	$5,735,463
Fiscal 1975:				
Granted	225,000	363,000	9.25 to 12.56	5,945,420
Exercised	(2,340)		9.625	(22,522)
Cancelled	(189,100)		9.625 to 27.875	(5,092,438)
Outstanding, February 28, 1976	289,860	363,000	9.25 to 12.56	6,565,923
Fiscal 1976:				
Granted	41,500	110,000	11.00 to 12.44	1,807,325
Exercised	(11,160)	(900)	9.25 to 9.625	(115,740)
Cancelled	(23,900)	(2,000)	9.625 to 11.81	(265,498)
Outstanding, February 26, 1977	296,300	470,100	$9.25 to $12.56	$7,992,010
Shares becoming exercisable in:				
Fiscal 1975	17,420	225,000	$9.25 to $10.82	$2,275,318
Fiscal 1976	65,680	92,000	$9.625 to $12.56	$1,730,112

Litigation

In the 1974 Annual Report, the Company reported on an antitrust judgment entered in favor of a Mr. Bray and five other cattle producers or feeders in the amount of $35.8 million plus interest. The Company settled this action in 1975 (for payments over the next four years having a present value of about $7 million, which was charged to operations in fiscal 1975) and the judgment was vacated and the action dismissed.

During 1975 and 1976, nine similar antitrust suits alleging violations of sections of the Sherman Act were filed in five states, and all of these were consolidated for pretrial purposes in the Dallas Federal Court. One of these actions was purportedly brought on behalf of a class consisting of all persons who are engaged in the business of raising fat cattle who have not otherwise filed claims and who sold more than 100 head of fat cattle per year. Each of these suits names the Company and other retail food chains as defendants and asks damages and other relief which may include an injunction. While most of these plaintiffs have not specified the amounts of damages they are claiming, their aggregate claims are substantial. In the actions in which money damages are specified or estimated, the plaintiffs allege damages exceeding $170 million.

The Company also is a named defendant in an action in which partners in a citrus grove, who purport to act on behalf of a class of citrus fruit growers in the State of Florida, allege violations of the antitrust laws by the Company and other retail food chains and orange product processors which reduced the wholesale price of citrus fruits to artificially low levels. They seek unspecified treble damages plus injunctive relief and attorneys' fees.

The Company is also a defendent in an action brought by some fifty-seven growers of cherries against the Company, other retail food chains, purchasing agents, packers and shippers of fresh Washington cherries.The complaint alleges violations of the antitrust laws which reduced the prices paid for cherries and seeks treble damages of an unspecified amount plus injunctive relief and attorneys' fees.

During the past year, the Federal Trade Commission found that the Company had violated the Robinson-Patman Act in purchasing dairy products in the Chicago area, but dismissed other charges against the Company. The Company has appealed that decision and it is now under review by the United States Court of Appeals for the Second Circuit. While no monetary judgment is expected to result in that proceeding, whatever the final outcome, there is a related civil action in Chicago Federal Court in which plaintiffs assert antitrust violations and demand unstated treble damages on behalf of an alleged class of competitors in the Chicago area.

In the above private actions, all of which are in the preliminary pretrial stages, money damages awarded to plaintiffs, if any, would automatically be trebled and such a judgment would also include reasonable plaintiffs' attorneys' fees.

The Company denies all allegations of wrong-doing in these actions. Because it is not possible to predict the ultimate outcome of any of them, no provision for possible resulting liability has been made in the accompanying financial statements.

The Company is also involved in various other claims, administrative agency proceedings and lawsuits arising out of the normal conduct of its business.

Retirement Plans

Retirement benefits for substantially all full-time and certain part-time employees are provided under the companies' retirement plans or by industry plans administered jointly by management and union representatives. The major portion of such employees are covered by industry plans.

The cost of all retirement plans amounted to $45.0 and $50.1 million in fiscal 1976 and 1975, respectively. The companies' independent actuaries estimate that vested benefits under the companies' plans exceeded the plans' assets by approximately $14 million at December 31, 1976, the end of the plans' year.

Leases

Most operations of the companies are conducted in leased premises. The unexpired non-cancellable terms of such leases at February 26, 1977 range up to twenty-five years for store leases and thirty years for other leased facilities. The majority of the leases contain escalation clauses relating to property tax increases, and certain of the store leases provide for increases in rentals when sales at the stores exceed specified levels. All leases are presently accounted for as operating leases.

The estimated present value of minimum rentals (net of amounts applicable to taxes and insurance) on noncapitalized finance leases, as defined by the Securities and Exchange Commission, at February 26, 1977 and February 28, 1976, exclusive of remaining lease obligations provided for in the facilities closing reserve, amounted to $116.2 million and $94.7 million, respectively. Interest rates used in the present value computations, ranging from 4.25% to 11.25%, resulted in weighted average interest rates of 8.5% and 7.6% in fiscal 1976 and 1975, respectively.

If all financing leases had been capitalized, the related property rights amortized on the straight-line method and interest expense recorded on the basis of the outstanding lease obligations, costs would have increased for fiscal 1976 and 1975 by approximately $2.3 million and $2.2 million, respectively. The assumed amortization and interest costs for fiscal 1976 and 1975 would have been as follows: amortization $4.5 million and $4.5 million, respectively; interest $7.3 million and $7.2 million, respectively.

Rent expense for fiscal 1976 and 1975, and minimum annual rentals for leases in effect at February 26, 1977 are shown in the tables below. All amounts are net of minor sublease rentals and exclusive of lease obligations included in the facilities closing reserve.

Rent Expense, Net of Minor Sublease Rentals

(Dollars in thousands)

Fiscal 1976	Financing Leases	Other Leases	Total
Minimum rentals	$ 13,026	$ 93,082	$106,108
Contingent rentals	358	3,984	4,342
Total	$ 13,384	$ 97,066	$110,450
Fiscal 1975			
Minimum rentals	$ 11,884	$ 84,562	$ 96,446
Contingent rentals	219	2,124	2,343
Total	$ 12,103	$ 86,686	$ 98,789

Minimum Annual Rentals, Net of Minor Sublease Rentals

(Dollars in thousands)

Year Ending in February	Financing Leases	Other Leases	Total
1978	$ 14,165	$ 75,348	$ 89,513
1979	14,165	70,235	84,400
1980	14,165	64,652	78,817
1981	14,165	58,527	72,692
1982	14,165	51,147	65,312
1983-1987	70,366	194,951	265,317
1988-1992	68,266	130,571	198,837
1993-1997	38,827	55,027	93,854
1998-2005	17,799	4,130	21,929
Total	$266,083	$704,588	$970,671

Replacement Cost
(Unaudited)

In compliance with recently established regulations, the Company is required to include, in its Form 10-K to be filed with the Securities and Exchange Commission, a copy of which is available upon request, certain estimated replacement cost data applicable to inventories, productive capacity, cost of merchandise sold and depreciation. Because of the rapid turnover of inventories, the carrying value of inventories is assumed to approximate replacement cost and therefore cost of merchandise sold reflects approximate replacement cost at time of sale. The additional depreciation charges associated with the cost of replacing fixed assets is normally accompanied by improvements in productivity, reduction in energy consumption and other economies, although these economies are not readily quantifiable.

Haskins & Sells
Certified Public Accountants

To the Board of Directors and Stockholders of The Great Atlantic & Pacific Tea Company, Inc.:

We have examined the consolidated balance sheet of The Great Atlantic & Pacific Tea Company, Inc. and subsidiary companies as of February 26, 1977 and February 28, 1976 and the related statements of consolidated income and retained earnings and of changes in consolidated financial position for the respective 52 and 53-week periods then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed under the caption Litigation in the Financial Review which accompanies the financial statements, the Company is a co-defendant in legal actions seeking monetary damages for alleged violations of Federal antitrust laws. Because of the uncertainty of the ultimate outcome of these actions, no provision for possible liability has been made in the financial statements.

In our opinion, subject to the effect on the financial statements of the resolution of the legal proceedings referred to in the preceding paragraph, such financial statements present fairly the financial position of the companies as of February 26, 1977 and February 28, 1976 and the results of their operations and the changes in their financial position for the respective 52 and 53-week periods then ended, in conformity with generally accepted accounting principles consistently applied.

Haskins & Sells

Two Broadway
New York, N.Y. 10004
May 2, 1977

Statement of Consolidated Income and Retained Earnings

The Great Atlantic & Pacific Tea Company, Inc. (Dollars in thousands, except per share figures)	52 Weeks to February 26, 1977 (Fiscal 1976)	53 Weeks to February 28, 1976 (Fiscal 1975)
Sales	$7,235,854	$6,537,897
Cost of merchandise sold	5,770,698	5,260,844
Gross margin	1,465,156	1,277,053
Store operating, general and administrative expense	1,435,136	1,311,692
Income (loss) from operations	30,020	(34,639)
Adjustment of (provision for) cost of closing facilities	(500)	35,000
Interest:		
Income—Primarily on temporary cash investments	2,473	1,987
Expense	(7,767)	(6,434)
Income (loss) before income taxes and extraordinary credit	24,226	(4,086)
Income taxes—Provision (credit)	10,445	(6,600)
Income before extraordinary credit	13,781	2,514
Extraordinary credit—Tax benefit of net operating loss carryforward	10,000	1,800
Net income	23,781	4,314
Retained earnings—Beginning of year	45,549	41,235
Retained earnings—End of year	$ 69,330	$ 45,549
Earnings per common share:		
Income before extraordinary credit	$ .56	$ .10
Extraordinary credit	.40	.07
Net income	$ .96	$ .17

See Financial Review and Summary of Significant Accounting Policies on pages 14 through 20.

Assets (Dollars in thousands)	February 26, 1977	February 28, 1976
Current assets:		
Cash	$ 25,187	$ 57,010
Short-term investments—at cost (approximates market)	1,044	13,988
Accounts receivable	49,813	35,206
Refundable income taxes	—	7,800
Inventories	567,011	518,201
Properties held for development and sale	14,596	—
Prepaid expenses	9,434	10,997
Total current assets	667,085	643,202
Property:		
Land	9,047	9,476
Buildings	75,420	80,738
Equipment	360,262	339,680
Total—at cost	444,729	429,894
Less accumulated depreciation	180,817	169,999
	263,912	259,895
Store fixtures and leasehold improvements, at amortized cost	107,350	94,279
	371,262	354,174
Less allowance for loss on property in facilities to be closed	3,000	15,000
Property—net	368,262	339,174
Other assets	9,550	6,901
Total	$1,044,897	$989,277

Liabilities And Stockholders' Equity (Dollars in thousands)		
Current liabilities:		
Current portion of long-term debt	$ 593	$ 272
Accounts payable	293,539	276,369
United States and foreign income taxes	1,423	1,447
Accrued salaries, wages and employee benefits	62,923	48,773
Accrued taxes, other than income taxes	15,881	18,240
Current portion of facilities closing reserve	18,500	27,500
Other accruals	30,921	26,732
Total current liabilities	423,780	399,333
Long-term debt	107,592	78,520
Deferred income taxes—net	13,783	11,809
Deferred income—principally investment tax credit	5,800	8,096
Facilities closing reserve and other liabilities	22,430	43,905
Stockholders' equity:		
Preferred stock—no par value; authorized—3,000,000 shares; issued—none		
Common stock—$1 par value; authorized—40,000,000 shares outstanding—1976—24,891,124 shares; 1975—24,879,064 shares	24,891	24,879
Capital surplus	377,291	377,186
Retained earnings	69,330	45,549
Total stockholders' equity	471,512	447,614
Total	$1,044,897	$989,277

See Financial Review and Summary of Significant Accounting Policies on pages 14 through 20.

Statement of Changes in Consolidated Financial Position

(Dollars in thousands)	52 Weeks to February 26, 1977 (Fiscal 1976)	53 Weeks to February 28, 1976 (Fiscal 1975)
Source of funds:		
From operations:		
Net income before extraordinary credit	$ 13,781	$ 2,514
Expenses (income) not requiring (providing) working capital:		
Adjustment of facilities closing reserve (non-current portion)	(7,200)	(27,000)
Depreciation and amortization	54,590	53,709
Deferred income taxes (non-current portion)	1,974	850
Deferred investment tax credit	(1,805)	(1,808)
Charge in lieu of current U.S. income tax	10,000	—
Charge in lieu of current Canadian income tax	—	1,800
Foreign currency fluctuation reserve	—	(1,137)
Loss on disposition of property not included in facilities closing program	6,850	—
Non-current portion of litigation settlement	—	4,800
Working capital provided from operations	78,190	33,728
Proceeds from disposition of property	12,055	29,886
Proceeds from borrowings	110,776	151,200
Total	201,021	214,814
Disposition of funds:		
Expenditures for property	94,633	65,880
Current maturities and repayment of long-term debt	81,704	111,755
Transfer of non-current facilities closing reserves to current liabilities	21,200	6,000
Other	4,048	1,333
Total	201,585	184,968
Increase (decrease) in working capital	(564)	29,846
Working capital—Beginning of year	243,869	214,023
Working capital—End of year	$243,305	$243,869
Increase (decrease) in components of working capital:		
Cash and short-term investments	$ (44,767)	$ 12,282
Accounts receivable	14,607	6,341
Refundable income taxes	(7,800)	7,800
Inventories	48,810	(54,068)
Properties held for development and sale	14,596	—
Prepaid expenses	(1,563)	(3,267)
Net change in current assets	23,883	(30,912)
Accounts payable and current portion of long-term debt	17,491	9,453
United States and foreign income taxes	(24)	(2,662)
Accrued expenses	15,980	4,951
Current portion of reserve for facilities closing program	(9,000)	(72,500)
Net change in current liabilities	24,447	(60,758)
Increase (decrease) in working capital	$ (564)	$ 29,846

See Financial Review and Summary of Significant Accounting Policies on pages 14 through 20.

Management's Comments

The following are Management's comments on significant changes during the last ten years. These comments should be read in conjunction with the Ten Year Summary of Operations on page 26, the discussion of fiscal 1976 operating results on page 15, and the discussion of the facilities closing program on page 16.

Fiscal 1976 Compared to Fiscal 1975

Sales for the 52 weeks of fiscal 1976 were $7.236 billion compared with $6.538 billion in the 53 weeks of fiscal 1975. This 11% increase in sales was moderated by the effect of the 53rd week in fiscal 1975. Average weekly sales for fiscal 1976 were 13% above the prior year although much of this increase occurred in the first and second quarters of the fiscal year.

Gross margin as a percent of sales was 20.2% in fiscal 1976 as compared with 19.5% in fiscal 1975. This increase was due, in part, to merchandising programs begun in fiscal 1975 and improvements in the product mix.

Store operating, general and administrative expenses decreased from 20.1% of sales in fiscal 1975 to 19.8% in fiscal 1976 due to the dramatic rate of sales increases experienced in the early part of the fiscal year. The Company's expense rate, however, was affected adversely by the disparity in rates of inflation in revenues and in costs. The Consumer Price Index for food at home rose an average of approximately 2% during fiscal 1976 while costs were subject to a much higher rate of inflation. Interest expense increased due to the higher level of borrowing in fiscal 1976.

Fiscal 1976 net income of $23.8 million is after an extraordinary credit of $10 million representing the tax benefit of the Company's net operating loss carryforward.

Fiscal 1975 Compared to Fiscal 1974

Fiscal 1975 sales were 4.9% below the sales of $6.875 billion in fiscal 1974 due to the closing of approximately 1,360 stores under the facilities closing program. Gross margin as a percent of sales was .3% lower than fiscal 1974 reflecting the Company's increased price competitiveness. Store operating, general and administrative expenses increased from 19.3% of sales in fiscal 1974 to 20.1% in fiscal 1975 due to the cost of the store refurbishing program, the settlement of litigation, increased advertising and the general inflationary increases in costs.

Net income for fiscal 1975 is primarily attributable to the $35 million net reversal of the facilities closing reserve and the $6.6 million credit provision for income taxes.

Significant Changes Prior to Fiscal 1975

The pre tax loss for fiscal 1974 of $168.3 million includes a $200 million provision for the costs of a facilities closing program to close marginal and unprofitable stores along with some support facilities. Operating results for fiscal 1972 reflects the reduced margin and other costs of a program to reverse a declining trend in market share which resulted in a net loss of $51.3 million.

Fiscal 1971 net income was affected adversely by the U.S. Government imposed price freeze and economic controls.

Ten-Year Summary of Operations

(Dollars in thousands, except per share figures)

For the fiscal year	1976	1975(c)	1974
Summary of operations			
Sales	$7,235,854	6,537,897	6,874,611
Cost of merchandise sold	$5,770,698	5,260,844	5,514,580
Gross margin	$1,465,156	1,277,053	1,360,031
Store operating, general and administrative expense	$1,435,136	1,311,692	1,326,601
Income (loss) from operations	$ 30,020	(34,639)	33,430
Adjustment of (provision for) cost of closing facilities	$ (500)	35,000	(200,000)
Interest:			
Income—primarily on temporary cash investments	$ 2,473	1,987	2,083
Expense	$ (7,767)	(6,434)	(3,78[illegible]
Income (loss) before income taxes and extraordinary credit	$ 24,226	(4,086)	(168,271)
Income taxes—provision (credit):			
United States income taxes:			
Current	$ 10,000	(7,600)	4,258
Deferred—net	$ —	7,400	(19,105)
State income taxes	$ 100	(25)	1,100
Foreign income taxes:			
Current	$ 176	1,983	736
Deferred	$ 1,974	250	(1,115)
Investment credit:			
Deferred	$ —	(6,800)	4,850
Amortized	$ (1,805)	(1,808)	(1,924
Total income taxes	$ 10,445	(6,600)	(11,200
Income (loss) before extraordinary credit	$ 13,781	2,514	(157,071)
Extraordinary credit	$ 10,000	1,800	—
Net income (loss)	$ 23,781	4,314	(157,071)
Per cent of sales	.33	.07	(2.2[illegible]
Depreciation and amortization	$ 54,590	53,709	51,620
Retirement plans	$ 45,033	50,092	37,574
Number of employees	90,000	92,900	105,000
Number of stores	1,978	2,074	3,468
Total store-area (square feet)	38,478,000	39,202,000	55,763,000
Balance Sheet Data			
Total assets	$1,044,897	989,277	1,020,708
Working capital	$ 243,305	243,869	214,02[illegible]
Current ratio	1.57	1.61	1.47
Additions to property	$ 94,633	65,880	80,363
Property—net	$ 368,262	339,174	340,889
Long-term debt	$ 107,592	78,520	39,07[illegible]
Stockholders' equity	$ 471,512	447,614	443,277
Common Stock Data			
Income (loss) per share before extraordinary credit (a)	$ .56	.10	(6.31
Extraordinary credit per share (a)	$ .40	.07	—
Net income (loss) per share (a)	$ .96	.17	(6.31
Cash dividends per share	—	—	.4[illegible]
Stockholders' equity per share (b)	$ 18.94	17.99	17.[illegible]
Shares outstanding (a)	24,885,630	24,878,012	24,876,6[illegible]
Number of stockholders	40,200	40,900	42,10[illegible]

(a) Based on the weighted average number of common shares outstanding each year.

(b) Based on the number of common shares outstanding at each year-end.

1973	1972	1971	1970	1969(c)	1968	1967
6,747,689	6,368,876	5,508,508	5,664,025	5,753,692	5,436,325	5,458,824
5,513,573	5,267,409	4,416,905	4,523,288	4,622,312	4,383,201	4,412,396
1,234,116	1,101,467	1,091,603	1,140,737	1,131,380	1,053,124	1,046,428
1,213,212	1,207,478	1,071,674	1,049,412	1,026,525	964,688	946,795
20,904	(106,011)	19,929	91,325	104,855	88,436	99,633
—	—	—	—	—	—	—
1,662	1,286	2,124	3,635	3,113	1,932	2,064
(3,439)	(2,252)	(501)	(601)	(222)	(121)	—
19,127	(106,977)	21,552	94,359	107,746	90,247	101,697
3,168	(51,484)	2,891	33,883	41,750	32,824	34,439
2,687	656	4,619	6,916	6,065	5,174	4,569
600	(1,700)	433	2,730	2,544	(d)	(d)
571	—	64	4,192	4,536	5,507	5,643
(821)	(1,628)	(656)	(2,000)	—	—	—
2,502	580	1,855	641	1,666	3,381	2,837
(1,807)	(2,124)	(2,273)	(2,132)	(2,117)	(1,886)	(1,688)
6,900	(55,700)	6,933	44,230	54,444	45,000	45,800
12,227	(51,277)	14,619	50,129	53,302	45,247	55,897
—	—	—	—	—	—	—
12,227	(51,277)	14,619	50,129	53,302	45,247	55,897
.18	(.81)	.27	.89	.93	.83	1.02
49,570	48,870	48,536	50,079	50,465	50,648	49,856
27,770	21,313	18,091	9,659	9,410	12,573	20,812
113,800	123,600	113,600	125,000	130,100	131,500	134,900
3,680	3,940	4,264	4,427	4,575	4,713	4,724
56,354,000	57,590,000	58,628,000	58,685,000	58,922,000	59,541,000	58,650,000
1,018,599	1,020,819	972,934	978,870	957,073	911,796	884,001
294,555	329,437	324,683	346,510	335,836	317,331	310,308
1.82	2.01	2.21	2.35	2.29	2.32	2.34
55,035	48,458	61,987	60,062	63,259	61,415	63,357
360,253	358,096	374,137	353,652	344,760	336,607	326,471
2,274	55,000	—	—	—	—	—
611,532	599,301	665,503	680,112	662,321	640,492	627,366
.49	(2.06)	.59	2.02	2.15	1.82	2.25
—	—	—	—	—	—	—
.49	(2.06)	.59	2.02	2.15	1.82	2.25
—	.60	1.175	1.30	1.30	1.30	1.60
24.58	24.09	26.75	27.34	26.63	25.80	25.28
24,875,259	24,875,224	24,875,224	24,875,010	24,854,654	24,822,021	24,817,308
43,500	45,000	53,400	47,900	52,700	53,400	52,300

(c) 53 weeks; all other years contained 52 weeks.

(d) Included under store operating, general and administrative expenses.

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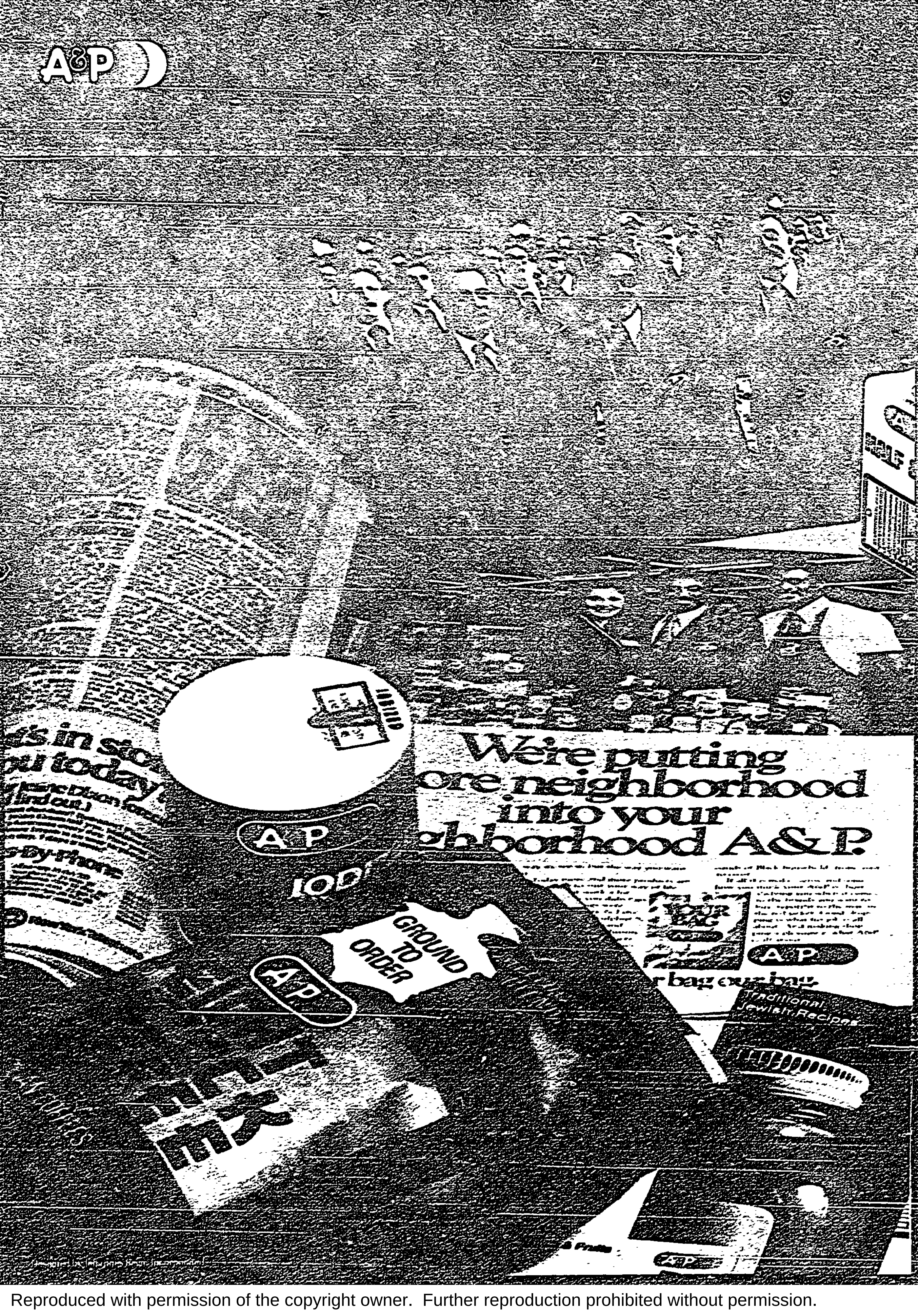
Transfer Agent and Registrar
Morgan Guaranty Trust Company
Of New York
New York, N.Y.

Common stock of the Company is traded on the New York Stock Exchange under the symbol "GAP," and has unlisted trading privileges on the Boston, Midwest, Philadelphia-Baltimore-Washington, Pittsburgh, Cincinnati and Detroit Stock Exchanges.

The Annual Meeting will be held on Friday, June 17, 1977 at 10 a.m. at The Ritz-Carlton Hotel in Chicago, Illinois. Stockholders are cordially invited to attend.

Copies of the Form 10-K submitted to the Securities and Exchange Commission will be provided to stockholders upon written request to the Secretary.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